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Tax Features

Average Family Faces Tax Bill of $12,938 in 1990

President Bush has released the Administration's budget to an uproar of criticism and commentary from interest groups all along the political spectrum, but few people are asking the most basic, down-to-earth question: How much will the government tax the average American family and how will that money be spent? According to Tax Foundation economists, a moderate-income family — two workers earning $45,000 with two dependent children — faces a tax bill of $12,938 for 1990. That covers the family's direct and indirect federal taxes. Add to this its $718 "share" of the federal deficit and the average family will contribute $13,656 to support the estimated $1.23 trillion Uncle Sam plans to spend in the new budget.

"Interest payment on the federal debt, . . . at $173 billion, costs a family 13 and 1/2 cents of its tax dollar, or a whopping $1,751 per year."

Assuming that the $12,938 tax bill is allocated to cover the typical family's entire share of federal spending, the following expenditures stand out:

- Income security tops the list at $418.5 billion. This comprises primarily Social Security, federal retirement, and unemployment, extracting 33 cents for each $1 the American family sends to Washington, for a per-family total of $4,237.
- National defense will cost $303.3 billion — or 24 cents out of each tax dollar. For the moderate-income family, this amounts to $3,070 per year.
- Interest payment on the federal debt ranks third at $173 billion, costing a family 13 and 1/2 cents of its tax dollar, or a whopping $1,751 per year.

See Median Family on page 2

FRONT BURNER

Let's Bring Glasnost to Revenue Estimates

Sen. Robert W. Kasten, Jr.

Thanks to the Freedom of Information Act, most of our government's actions are open to public scrutiny. But one major exception remains — the making of U.S. tax law.

The Congressional tax-writing process remains shrouded in secrecy. The fate of proposed tax changes — like cutting the capital gains tax or expanding savings incentives — are often decided behind closed doors by the accountants and economists who make revenue estimates.

For the past 50 years, the revenue estimates prepared by the Joint Committee on Taxation and the Treasury Department played only a minor role in the making of Federal tax policy; the estimates merely provided legislators with helpful reference points for proposed tax changes. But the rising budget deficits and tighter Gramm-Rudman budget procedures have heightened the role of these estimates to the point that they often dictate policy, to the detriment of other important goals like fairness, efficiency and economic growth.

To be sure, the revenue-neutrality test imposed by the Gramm-Rudman process is an important fiscal restraint, and we ought to stick to it. That's why it is essential for Congress to have accurate estimates for proposed tax legislation.

But in some of the most important tax policy debates of the last decade and a half, the official estimates were often misleading, incomplete and incorrect — leading Congress

See Kasten on page 5

Robert W. Kasten, Jr., a Republican, is the senior U.S. Senator from Wisconsin.

Ed. Note: The Front Burner is a forum for participants in the fiscal arena to express their opinions on tax and budget issues. These opinions are not necessarily those of the Tax Foundation. Editorial replies are encouraged.

Tax Foundation

IN THIS ISSUE

U.S. Family Tax Dollar	1
"Front Burner"	1
Bush Budget Highlights	3
President's Message	4
R&D Seminar	6

Median Family from page 1

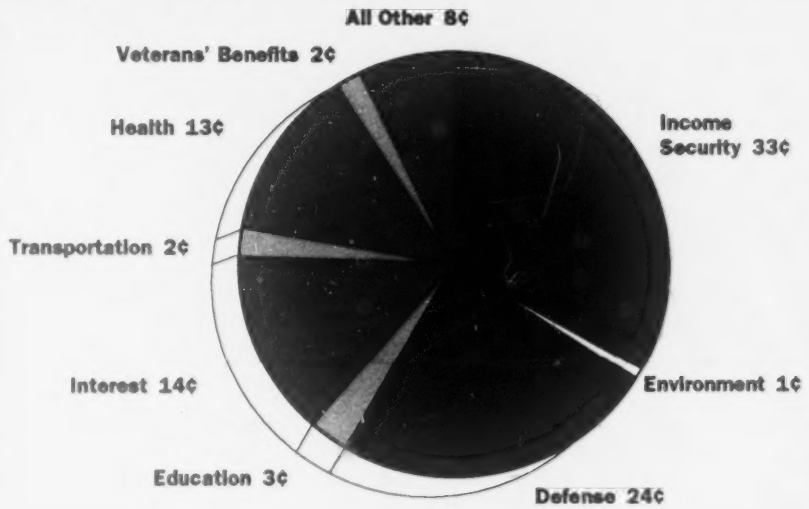
■ Health outlays, mainly Medicare and Medicaid, will take 13 cents of each tax dollar. The typical family will send Uncle Sam $1,643 in 1990 to pay for the $162.3 billion national health bill.

"The typical family will send Uncle Sam $1,643 in 1990 to pay for the $162.3 billion national health bill."

These four items alone will claim 83 percent of all federal spending and will cost the moderate-income family $10,701, or 83 cents of each tax dollar. Compared to these big four items, spending on all other programs is relatively small. With the remaining 17 cents, Uncle Sam will spend 3 cents of the family's tax dollar on education, and less than 3 cents each on environment, transportation, science, and administration of justice.

"Uncle Sam will spend less than 3 cents per dollar each on environment, transportation, science, and administration of justice."

How the Federal Government Will Spend the Average Family's Tax Dollar in 1990

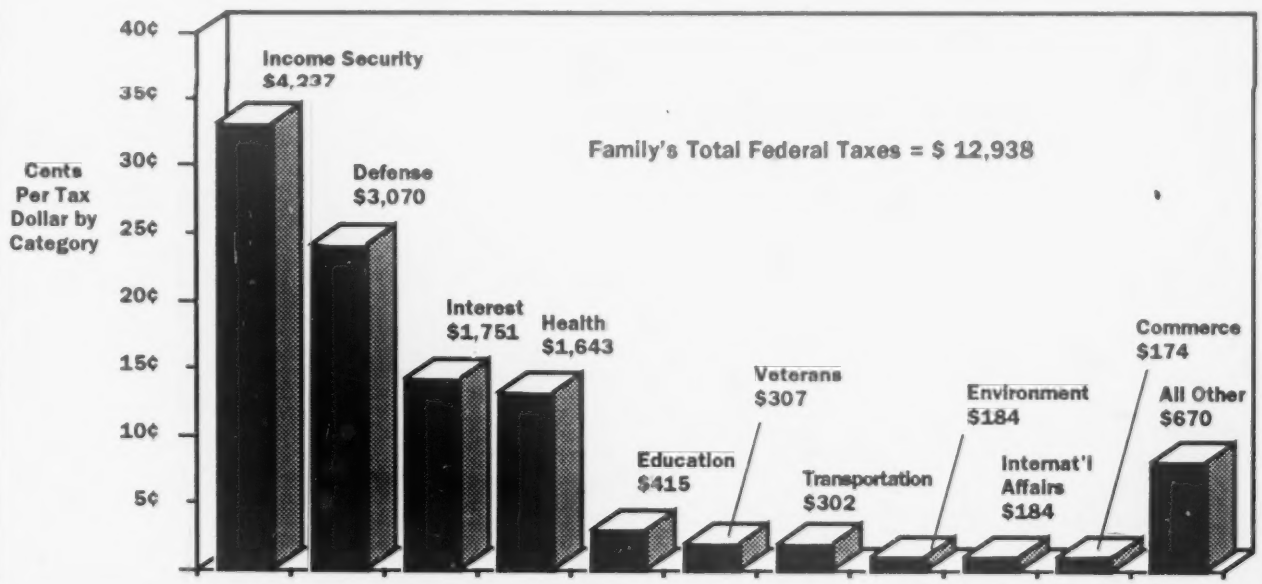


The Family Tax Bill

Direct federal taxes — individual income and personal Social Security taxes — will cost this family $8,219 in 1990. However, direct levies do not explain the whole tax burden, accounting for only about three-fifths of what the government takes in. To these must be added such indirect taxes as the employer's share of Social Security taxes; corporate income taxes; excise taxes on such items as gasoline, liquor, and

See Median Family on page 6

How the Federal Government Will Spend the Average U.S. Family's Taxes in 1990



Highlights of the President's FY1991 Budget

By James C. Miller III

The release of President Bush's 1991 budget proposal has been met with predictable, inside-the-beltway partisan sniping and canned "sound bites." The budget would meet the Gramm-Rudman-Hollings deficit target of $64 billion for fiscal year 1991 without substantial new taxes or increases in tax rates. Some major points about President Bush's budget are highlighted below:

If enacted (and if the Administration's economic assumptions hold true), receipts to the Federal government would rise by $96.7 billion ($1,073.5 billion to $1,170.2 billion) — $82.8 billion from inflation, economic growth, and tax code changes already enacted and $13.9 billion in proposed policy changes. This represents a 9.0 percent increase — or a 5.0 percent increase after adjusting for inflation.

Government outlays would rise by $36 billion ($1,197.2 billion to $1,233.3 billion), or 3.0 percent — 1.0 percent less than inflation. This would constitute the first reduction in real spending since 1987 (which, in turn, was the first in two decades).

"The president's . . . three-point savings initiative . . . will undoubtedly be the first step in a long process of partisan wrangling that surrounds the saving issue."

Offsetting collections are revenues that show up as "negative outlays" and thus mask the total amount of government revenue and spending. President Bush's budget submission decreases offsetting collections by $7.4 billion (from $154.0 billion to $146.6 billion), primarily because of a substantial reduction in premiums paid by savings and loan institutions. If offsetting collections are added to the revenue and outlay figures, total revenues would go up by 7.3 percent, and outlays would go up 2.1 percent.

The president's budget also includes a three-point savings initiative. This initiative reduces capital gains tax rates based on the length of time an asset is held, and provides a maximum exclusion of 30 percent on gains from investments held for more that three years. It allows use of Individual Retirement Accounts (IRAs) for first-time home purchases and creates Family Savings Accounts, which allow households with incomes below $120,000 to deposit up to $5,000 per year in seven-year, tax free accounts. This will undoubtedly be the first step in a long process of partisan wrangling that surrounds the saving issue.

Revenue-raising proposals likely to attract attention include extending Social Security coverage to state and local employees not participating in public employee retirement programs, permanently extending the telephone excise tax, and increasing airport and airway fees. The budget also includes new or expanded "user fees" for the Securities and Exchange Commission, the Internal Revenue Service, mine reclamation, the Commodity Futures Trading Commission, the Federal Emergency Management Agency, and the Corps of Engineers.

The budget includes a series of tax credit proposals. The president proposes to expand and make permanent research and experimentation tax credits, provide tax relief for the oil and gas industry, permanently extend the health insurance deduction for the self-employed, extend the low-income housing tax credit, establish a new tax credit for low-income families with young children, restore and double the adoption tax credit, and establish urban enterprise zones.

Spending initiatives emphasized in the Bush budget include increases in budget authority of $3.3 billion for space and other science programs, $4.5 billion for research and development programs, $500 million for Head Start, $1.1 billion for drug programs, and $2 billion for environmental programs.

President Bush also unveiled the "Social Security Integrity and Debt Reduction Fund." The plan would mandate that after 1993, Social Security trust fund surpluses be gradually used to pay down the national debt. The purpose of the plan is to increase the national savings rate and lower government interest payments. By 1996, 100 percent of the surpluses would be committed to the debt repayment fund. The Social Security Trust Funds reduce the 1991 deficit by $80 billion.

As expected, this budget has been controversial and criticized severely.

"Critics point to the Administration's proposals to "cut" Medicare. Actually, these proposals would only slow the growth in Medicare spending."

On the revenue side, some are disappointed that there is no major tax increase. On the other hand, many have criticized the Administration's proposed tax changes. The cut in the capital gains rate has generated charges of "tax cut for the rich," and critics have maintained that other provisions constitute "ducks," even though they don't waddle excessively. A third major criticism has been the treatment of the Social Security surplus.

On the outlay side, critics have focused on the absence of a "peace dividend." Rather than decrease, as many had predicted, total outlays for defense would go up — from $296.3 billion $303.3 billion. They have also pointed to the Administration's proposals to "cut" Medicare. Actually, these proposals would only slow the growth in Medicare spending (which would go up from $96.9 billion to $98.6 billion). And, there are controversies over priorities: whether the Administration has proposed enough for education, the environment, drug enforcement, AIDS research, and the like, and why it has proposed cuts in energy, commerce and housing credit, and some community and regional development programs.

See Bush Budget on page 4

James C. Miller III is a former Director of the Office of Management and Budget and currently serves as Co-Chairman of the Tax Foundation.

Bush Budget from page 3

Since this year is an election year, and Members of Congress have returned to Washington anticipating a peace dividend to spend, the going will be very rough for the President's budget. However, the alternatives (tax increases, spending cuts, drift in the deficit) appear politically unpalatable as well, and given the President's extraordinary popularity, the prospects appear reasonably good for a budget outcome that does not stray too far from the Administration's proposal.

On the outlay side, critics have focused on the absence of a "peace dividend."

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PRESIDENT'S MESSAGE

Bringing the Budget Home to the American Family

Wayne Gable

When President Bush released his 1991 budget in January, the attendant media noise nearly drowned out the average taxpayer's weary question, "How much is it going to cost me this year?" The Tax Foundation heard the cry of the American taxpayer and calculated the dollar impact of the new budget on the typical American family. (See page 1.)

Tax Foundation economists have computed not only the total the average family will pay, but the portion of that dollar amount to be spent on each category of government expenditure. This breakdown reveals that four categories of government spending — income security, defense, interest on the debt, and health — gobble up over four-fifths of our tax money.

This is the kind of analysis that the Tax Foundation will always strive to do. It brings the Budget of the United States— a 1,500-page document weighing over 5 pounds — down to size and supplies the raw information that citizens must have to answer such questions as: How much of the federal tax dollar goes toward education? What is the average family's contribution to income security? How much per family for defense?

We at the Tax Foundation are dedicated to bringing comprehensible information to the American people and have found that the media, who often have to rely on organizations with an ax to grind, are eager to use Tax Foundation data. On the morning after the budget's release, *ABC World News This Morning's* Stephen Aug broadcast the story which serves as this issue's lead. More often, we explain issues in government finance to reporters, supplying them with historical tables which serve as background for their own stories. But we do not shun this low key, behind-the-scenes role because our reputation as a reliable source of unbiased data was built and strengthened over the years through just this sort of informal educational activity.

The Tax Foundation's stated mission has always been to provide objective research and public education on the taxing and spending activities of federal, state and local governments. In the pursuit of this goal, we will strip away partisanship and rhetoric in favor of facts and clearcut analysis. In a nutshell, we will help the American people to know what is happening to their money.

NOTABLE

- **In 1970, spending on mandatory health programs totaled $9 billion, or 5% of total outlays. Now at $233 billion, it is over 15% of total outlays.**
- **Total mandatory programs were 34% of the budget in 1970. They will exceed 50% in 1991.**
- **Over $1 trillion in outstanding home mortgages have been guaranteed by the government.**
- **At the end of 1989, the face amount of federally assisted credit and insurance outstanding was $5.8 trillion, 2 and 1/2 times the national debt.**
- **The ratio of the federal debt to GNP rose from 27% in 1980 to a peak of 43% in 1988 and declined slightly in 1989.**

Tax Features

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Kasten from page 1

to enact misguided tax increases and reject much-needed tax cuts.

Case in point: Capital gains. In 1978, Treasury and the JCT claimed that cutting the top rate on capital gains from 50 to 28 percent would lose $2 billion in annual revenue. Over the next three years after the tax cut, the stock market boomed and revenues jumped $3.6 billion. The estimators had clearly failed to account for the behavioral response of investors who realized more gains due to the tax cut. (Similarly, the JCT estimates of the 1986 Tax Reform Act failed to predict a $20 billion revenue windfall in 1986 as investors sold assets late in the year to beat the capital gains tax increase in 1987.)

Case in point: 10 percent withholding on dividends and interest. The JCT claimed that the 10 percent withholding provision in the 1982 tax increase bill would raise $4.2 billion in 1983. Sen. Lloyd Bentsen (D-TX, now Chairman of the Senate Finance Committee) argued that withholding would "create an administrative nightmare and impose a substantial new burden and red tape on the private sector — and quite likely yield substantially less tax revenue than projected." Bentsen called the JCT's numbers "suspect" — charging that "the net revenue effect of this hastily drawn provision may be zero for all everyone knows."

Case in point: Tax Reform Act of 1986. Supply-siders argued that the JCT estimates should recognize the incentive effects of tax rate cuts (reduced avoidance, evasion, and consumption of untaxed fringe benefits) which mitigate the potential loss of tax revenues. The huge static loss estimates from the personal tax rate cuts resulted in a heavier tax burden on corporations ($140 billion) — thus stifling savings and investment. As a result, tax reform came dangerously close to tipping the economy into a recession, all for the sake of an unnecessary tax hike.

Case in point: Section 89. According to the JCT, the Section 89 uniform-benefits tax law repealed last year would raise $154 million in 1990. In fact, American businesses would have spent over $4 billion in deductible costs to comply with Section 89 — resulting in less tax revenue for the government. According to a private sector analysis based on a survey of businesses representing 19 percent of the workforce, Section 89 would have reduced revenues by $800 million in 1990.

In all these cases, the principle of "garbage in — garbage out" applies. Inaccurate statistics can lead to real legislative setbacks, and to an unwise and counterproductive national tax policy. In the Senate, "revenue-losing" tax provisions require 60 out of 100 votes before they can be considered — or else someone's taxes have to be raised.

I think it's high time that we open up the revenue estimating process to public scrutiny — and require JCT to measure the dynamic impact of tax changes on the real economy. In 1988, I introduced a bill called the Tax Policy Information Act to improve the revenue estimating process. The bill would require public disclosure of JCT's assumptions, data, and methodology used to arrive at revenue estimates.

"The fate of proposed tax changes — like cutting the capital gains tax or expanding savings incentives — are often decided behind closed doors by the accountants and economists who make revenue estimates."

The JCT estimators defend the secrecy of the process by claiming that public disclosure would bias the estimates. I believe that the opposite is true: Full disclosure could only improve the process, by making it responsive to the needs of the real economy. It would facilitate exchange between the JCT and outside economists, which would result in improved techniques, data collection and revenue modeling — all of which would lead to more accurate estimates.

The Congressional Budget Office (CBO) is an excellent example of what happens when you open up the process to the light of day. Their models and methods are well-documented and open to constructive criticism, and the result is integrity and realism in the estimating process.

Another necessary reform is to require dynamic revenue analysis as well as the prevalent — and highly unrealistic — static methods. A dynamic estimate predicts how a tax change will play out in the real world, as opposed to under the green eyeshades. For example: If a $10,000 tax were imposed on red cars, static estimates would multiply $10,000 by the number of red cars produced and predict large revenue gains. A dynamic revenue estimate would predict that most people would buy cars of another color — and thus predict very low revenue gains.

The JCT often chooses to ignore economic reality — and tax policy suffers as a result. In response to one query during the recent capital gains debate, JCT said that a 100 percent tax on incomes over $200,000 would raise between $200 and $300 million a year forever. In the bizarre Disneyland of static revenue estimates, men and women will continue to work in order to send all of their income over $200,000 to the government. Moreover, static assume that these men and women will not shelter or underreport their income.

Clearly, this kind of static estimate is highly unrealistic. In contrast, dynamic estimates take human behavior and economic reality into account. Even the JCT has moved in the direction of quasi-dynamic estimates in the case of capital gains. But it persists in predicting that cutting the capital gains rate to 15 percent would result in a long-term revenue loss — despite the predictable revenue-increasing effects of such a cut (like higher asset values and increased stock of capital).

While it's true that dynamic analysis is difficult, it is better to be imprecisely correct than precisely wrong.

And this is why the issue of revenue estimation is so important: Bad revenue estimates can create policies that wreck the economy. If we were to listen to the demagogues on capital gains — who all rely on static estimates — we would have no choice but to squelch this essential tax cut, thus yielding the competitive advantage irretrievably to the Japanese and others who know the unhappy truth about static estimates.

It's essential that we build economic policy on the solid ground of realistic estimates. To prevent abuse of the disclosure and dynamic-estimate

See Kasten on page 6

Median Family from page 2

tobacco; and miscellaneous levies. These will take another $4,719 from the average family's income.

Direct and indirect federal taxes will claim 28.8 percent of this family's annual income, but even that does not tell the whole story. All told, current federal taxes and borrowing will add up to nearly 30 percent of the moderate-income family's earnings.

See table below for further details.

Kasten from page 5

requirements, we should only apply them to tax changes that result in revenue changes of $100 million or more in a single year; but apply them we must. Revenue estimation isn't a parlor game — it's a matter of life and death for the millions of workers and business people who rely on a healthy economy. Let's implement these changes soon, before we get sidetracked into some awful economic folly we will all live to regret.

How the Federal Government Will Spend a Family's Tax Dollar in 1990[a]

Function	Family's Share: Amount	Family's Share: Percent of Total	Spending (Billions)
Income Security[b]	$ 4,237	32.75%	$ 418.5
National Defense	3,070	23.73	303.3
Net Interest	1,751	13.54	173.0
Health[c]	1,643	12.70	162.3
Education, Training, Employment, Social Services	415	3.21	41.0
Veterans' Benefits and Services	307	2.37	30.3
Transportation	302	2.33	29.8
Environment and Natural Resources	184	1.42	18.2
International Affairs	184	1.42	18.2
Commerce and Housing Credit	174	1.35	17.2
General Science, Space and Technology	168	1.30	16.6
Agriculture	151	1.17	14.9
Administration of Justice	128	0.99	12.6
General Government	114	0.88	11.3
Community and Regional Development	79	0.61	7.8
Energy	30	0.23	3.0
Total[d]	$ 12,938	100.00%	$ 1,233.3

[a] This example uses a two-earner family earning $45,000 per year with two dependent children.
[b] Primarily social security. Includes federal employee retirement, unemployment compensation, and nutrition assistance. Excludes veteran's income security.
[c] Primarily Medicare and Medicaid. Excludes veteran's health care.
[d] After deducting $44.7 billion in undistributed and offsetting receipts not classified by function.

Source: Tax Foundation computations based on Fiscal Year 1991 U.S. Budget presented January 29, 1990, and 1990 tax laws from U.S. Department of Treasury.

Tax Foundation to Hold Seminar on Tax Treatment of Research and Development

On Thursday, March 22, 1990, the Tax Foundation will host a seminar on R&D tax policy at the Hyatt Regency on Capitol Hill in Washington, DC. Starting at 12:30, an opening address will outline the issue and two panels of experts from government and industry will address the problems. After a closing address, an informal cocktail reception will follow from 5:30 to 7:30. Call Paul Merski for more information at 202-863-5454.

QUOTABLE

"If the Moynihan proposal were to set off a Great Debate that forced the nation to clarify its thinking about the nature of our social security programs, and that brought reality more in line with image, the senator will have made a major contribution to public policy."

Paul W. McCracken, professor emeritus, University of Michigan, and a former chairman of the President's Council of Economic Advisers.

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